September 16, 2003

D.T.E. 03-2

Joint Petition of Massachusetts Electric Company and Nantucket Electric Company, pursuant to G.L. c. 25, § 19, G.L. c. 25A, § 11G, and G.L. c. 164, § 17A, for approval by the Department of Telecommunications and Energy of its 2003 Energy Efficiency Plan, including a proposal for financial assistance to municipal energy efficiency projects.

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I. INTRODUCTION

On January 14, 2003, Massachusetts Electric Company and Nantucket Electric Company (together"MECo" or "Company"), after consulting with the energy efficiency collaborative,[1] filed with the Department of Telecommunications and Energy ("Department") an Energy Efficiency Plan covering calendar year 2003 ("2003 Plan"). On April 11, 2003, the Commonwealth of Massachusetts Division of Energy Resources ("DOER") filed with the Department its report on the 2003 Plan ("DOER Report"), pursuant to G.L. c. 25A § 11G; 225 C.M.R. § 11.00 et seq.; and Order Promulgating Final Guidelines to Evaluate and Approve Energy Efficiency Programs, D.T.E. 98-100, Att. 1 (2000) ("DTE Guidelines"). The DOER Report found that the 2003 Plan is substantially consistent with the statewide energy efficiency goals (DOER Report at 2). See 225 C.M.R. §§ 11.03.

On May 14, 2003, the Company submitted a revised filing ("Revised Filing") consisting of: (1) a revised benefit/cost analysis; (2) performance metrics for 2003; and (3) a request for Department approval, pursuant to G.L. c. 164, § 17A, of a financing proposal for municipalities participating in MECo's Energy Initiative and Design 2000plus energy efficiency programs. On May 22, 2003, the DOER filed a second report ("DOER Report 2") finding that the Revised Filing is consistent with the statewide energy efficiency goals.[2] The Department docketed the filings as D.T.E. 03-2.

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1 MECo developed the 2003 Plan with an energy efficiency collaborative composed of: (1) the Northeast Energy Efficiency Council; (2) the Energy Consortium; (3) Associated Industries of Massachusetts, Inc.; and (4) the Low-Income Affordability Network (January 13, 2003 MECo letter to the Department).

2 Although the Company filed the 2003 Plan with the Department on January 14, 2003, the Department can not initiate its review of energy efficiency plans until after DOER files its report to the Department approving the plans. G.L. c. 25A § 11G; G.L. c. 25, § 19; 225 C.M.R. § 11.04(6); DTE Guidelines at § 6.2(3).

On July 17, 2003, after notice duly issued, the Department conducted an evidentiary hearing. The Department granted limited participant status to: DOER; Associated Industries of Massachusetts ("AIM"); the Low-Income Affordability Network ("LEAN");[3] and the Massachusetts Climate Action Network ("MCAN").[4] The Company sponsored the testimony of Michael McAteer, manager of business energy efficiency services for National Grid USA Service Company, Inc.[5] The evidentiary record consists of three Company exhibits and thirteen Company responses to Department information requests.[6] DOER and MCAN submitted comments on the Company's filings.

II. STANDARD OF REVIEW

The Department is required to ensure that energy efficiency activities are delivered in a cost-effective manner utilizing competitive procurement processes to the fullest extent practicable. G.L. c. 25, § 19; G.L. c. 25A, § 11G. The Department has established guidelines that, among other things, set forth the manner in which the Department reviews ratepayer-funded energy efficiency plans in coordination with DOER, pursuant to G.L. c.25, § 19 and G.L. c. 25A, § 11G. See D.T.E. 98-100.

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3 LEAN is a voluntary association of community action program directors and others associated with the "low-income weatherization and fuel assistance program network" (LEAN Petition at 1). See G.L. c. 25, § 19. Low-income residential demand-side management and education programs are required to be implemented through the low-income and weatherization and fuel assistance program network. Id.

4 MCAN represents community groups in Massachusetts that are trying to reduce greenhouse gas emissions through reducing fossil use. Medford Climate Action Network and Salem Alliance for the Environment are MCAN entities in MECo's service territory (MCAN Petition at 2).

5 The Company is a subsidiary of National Grid USA (Exh. ME-1).

6 In addition, the Department incorporates by reference into the record of this proceeding the DOER Report and the DOER Report 2. 220 C.M.R. § 1.10(3).

DOER has the authority to oversee and coordinate ratepayer-funded energy efficiency programs, consistent with specified goals, and is required to file annual reports with the Department regarding proposed funding levels for said programs. G.L. c. 25A, § 11G; 225 C.M.R. §§ 11.00 et seq. If the DOER report concludes that ratepayer-funded energy efficiency programs are consistent with state energy efficiency goals, and if no objection to the DOER report is raised, the Department's review of the 2003 Plan is limited to cost-effectiveness issues and the use of competitive processes. DTE Guidelines at § 6.2; 225 C.M.R. §§ 11.00 et seq.

III. 2003 ENERGY EFFICIENCY PLAN

A. Cost-Effectiveness

Pursuant to the DTE Guidelines: (1) an energy efficiency program shall be deemed cost-effective if its benefits are equal to or greater than its costs, as expressed in present value terms and (2) before implementation, each Program Administrator shall file with the Department sufficient information, including assumptions, to support the determination of cost-effectiveness for all proposed energy efficiency programs. DTE Guidelines at §§ 3.5, 4.2.1.[7]

MECo estimated the pre-implementation benefit/cost ("B/C") ratio for each energy efficiency program proposed for 2003 (Exh. DTE-1-9 (Rev.), Amended App. A-v2, at 1). With respect to its residential energy efficiency programs, MECo estimated pre-implementation B/C ratios greater than 1.00 for all such programs (id.). However, MECo

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[7] Each energy efficiency program is subject to a post-implementation evaluation, addressing post-implementation estimates of energy savings, capacity savings, and other savings as well as post-implementation costs. Shareholder incentives are also determined as a result of the post-implementation evaluation. See DTE Guidelines §§ 4.1, 4.2.2, 5.3.

estimated that three of its residential energy efficiency programs result in pre-implementation B/C ratios only slightly greater than 1.00: (1) the Energy Wise Program with a B/C ratio of 1.02; (2) the Residential Conservation Service with a B/C ratio of 1.02; and (3) the Energy Star Appliances Program with a B/C ratio of 1.16 (id.).

With respect to its low-income energy efficiency programs, MECo estimated the pre-implementation B/C ratios for two programs (id.). MECo estimates the pre-implementation B/C ratio of MECo's In-Home Services program to be 2.56, while the pre-implementation B/C ratio for MECo's New Construction program is 1.59 as estimated on a combined basis with its non-low-income counterpart (Exh. DTE-1-9 (Rev.), Amended App. A-v2, at 1; Exh. DTE-1-9(e) (Rev.)).

With respect to its commercial and industrial programs ("C/I"), MECo estimated pre-implementation B/C ratios greater than 2.00 for all such programs (Exh. DTE-1-9 (Rev.), Amended App. A-v2, at 1).

The Company stated that its pre-implementation B/C ratios were estimated consistent with the Department's Total Resource Cost ("TRC") method (Exhs. MEC-3, at 9; DTE-1-9 (Rev.), Amended App. A-v2, at 1 of 3). See DTE Guidelines at §§ 3.00 et seq. The Company provided the assumed values that were used to develop the dollar estimates of capacity savings, energy savings, and other types of benefits and costs associated with the TRC method (Exhs. MEC-3, at Apps. A-C; DTE-1-10).

B. Competitive Procurement

MECo presented evidence that it competitively procures 85 percent of its residential (non-low income) program activities (Exh. MEC-3, at 8). The Company explained that it did not competitively procure its residential low-income program activities because, by statute, "low-income residential demand-side management and education programs shall be implemented through the low-income weatherization and fuel assistance program network" (Exh. DTE-1-3, citing G.L. c. 25, § 19). MECo presented evidence that it competitively procured 56 percent of its C/I program activities (Exh. MEC-3, at 8).

MECo stated that it competitively procures a high percentage of residential (non-low-income) activities because that sector is relatively homogeneous, and thereby subject to a high degree of outsourcing, and because residential programs such as Energy Star are competitively procured jointly with other electric companies (Exh. DTE-1-3). MECo noted that there are no such joint efforts with respect to its C/I sector, and that success in the C/I sector depends to a great extent on Company involvement, such as account managers and technical support representatives promoting programs directly to business customers (id.).

C. Analysis and Findings

1. Cost Effectiveness

The record indicates that MECo's energy efficiency programs estimate pre-implementation B/C ratios of at least 1.02. The Department reviewed the method by which the Company determined the benefits and costs for its programs, and finds that the benefits and costs were determined consistent with Department criteria for establishing program cost-effectiveness. DTE Guidelines at §§ 3-4. Accordingly, the Department finds that energy efficiency programs in the 2003 Plan are, as estimated in the pre-implementation phase, cost-effective.

The Department notes that the benefits and costs of each program in MECo's 2003 Plan are based on projections or forecasts of what benefits and costs may be expected. See DTE Guidelines at § 4.2.1. At this pre-implementation phase, the Department is concerned with energy efficiency programs with expected B/C ratios only nominally above 1.0, such as the Energy Wise Program with a B/C ratio of 1.02; the Residential Conservation Service program with a B/C ratio of 1.02; and the Energy Star Appliances Program with a B/C ratio of 1.16. The Department has previously noted its concern regarding energy efficiency programs with costs that might be greater than expected benefits. Massachusetts Electric Company, DTE 00-65, at 5 (2003) (directing MECo to improve cost-effectiveness of Residential Conservation Services program because B/C ratio is less than 1.0). While the programs in the 2003 Plan meet the DTE Guideline's criteria for cost-effectiveness in the pre-implementation phase, given the low B/C ratios exhibited by these programs, it is not a certainty that their cost-effectiveness will be sustained into the post-implementation phase. See DTE Guidelines at §§ 3.5, 4.2.2.[8] Higher B/C ratios in the pre-implementation phase would greatly increase the likelihood that these programs would operate cost-effectively over time and that the Department could find that MECo's "energy efficiency programs were implemented in a cost-effective manner" when the Department reviews and approves energy efficiency expenditures in the post-implementation phase. G.L. c. 25, § 19; G.L. c. 25A, § 11G; DTE Guidelines at § 4.2.2.

2. Competitive Procurement

The Company provided evidence that it competitively procures a high percentage of its residential non-low-income program activities, and that it complied with the requirements of G.L. c. 25, § 19 for low-income programs (Exh. MEC-3, at 8; Exh. DTE-1-3). MECo also presented evidence that it competitively procures its technical services for its C/I program

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[8] The Department notes that low B/C ratio programs warrant close monitoring and timely adjustment by the program administrator. See DTE Guidelines at § 4.2.2.

activities (Exh. MEC-3, at 8). Accordingly, the Department finds that the 2003 Plan provides for competitive procurement to the fullest extent practicable.

IV. MUNICIPAL FINANCING PROPOSAL

A. MECo Proposal

MECo requests Department approval, pursuant to G.L. c. 164, § 17A, of its proposal to provide financial and technical assistance to municipal customers to facilitate their municipal energy efficiency projects (Exh. MEC-1, at 3). MECo stated that, in light of severe budgetary constraints to municipalities, the costs of efficiency projects represent a significant hurdle to participation (RR-DTE-2). The Company stated that its proposal will make it easier for municipalities to install energy efficient measures which will lower their operating costs, and have no impact on other customers (Exh. MEC-1, at 7). MECo stated that it will target cities and towns that have not actively participated in the Company's energy efficiency program over the last five years (id., at 4). MECo stated that its financing proposal is designed to reduce financial barriers by offering municipalities incentives through two programs: (1) Design 2000plus; and (2) Energy Initiatives (Exh. MEC-1, at 3-4; Tr. at 25-26). The Company explained that the Energy Initiatives program is a retrofit program, while the Design 2000plus program targets new construction (Tr. at 26-27). Both programs are C/I energy efficiency programs (Exh. MEC-3, at 40-50).

Under the Energy Initiatives program, the Company stated that it would rebate sixty percent of total project costs, and allow the municipalities to pay their contribution in increments up to twenty-four months at no interest (Exh. MEC-2, at 2).[9] The Company noted

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[9] The Company stated that it would offer on-bill financing, i.e., the municipal customer could repay their share of a project for a period of up to 24 months, in equal monthly (continued...)

that the municipality would need no immediate cash to participate in the Energy Initiatives program (Tr. at 17-22). MECo added that it would pay the entire cost of technical assistance for the Energy Initiative program, but that many of the projects would not require technical assistance (Exh. MEC-1, at 3).

The Company stated that, in the Design 2000plus program, the municipalities could select premium energy efficiency equipment, and that the Company would pay the incremental difference between the standard and premium performing equipment (Exh. MEC-3, at 41; Tr. at 27-28). MECo added that it would also pay the entire cost of technical assistance for the Design 2000plus program (Exh. MEC-1, at 3).[10]

MECo also proposes to offer, on a pilot basis, similar financial assistance to about ten medium-sized C/I participants in Energy Initiatives or Design 2000plus (Exh. MEC-1, at 6; MEC-2, at 2). The Company explained that this would enable MECo to gain experience with the effect such financing may have on the ability of medium C/I customers to pursue energy efficiency projects (Exh. MEC-1, at 6).

The Company stated that it proposes to allocate approximately $2.3 million to the initiative (Exh. MEC-2, at 2; Tr. at 13-14). The Company will use funds solely from the

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[9](…continued)
installments on their electric bill (Exh. MEC-1, at 5).

[10] The Company stated that, where technical assistance is required, for both programs MECo will require municipalities to sign a memorandum of understanding that will indicate the municipality's intent to pursue projects identified through technical assistance (Exh. MEC 1, at 3). This requirement will be applicable to both programs.

systems benefit charge (Tr. at 19).[11] With respect to the level of funds available for the proposal, MECo stated that about $0.5 million is available for new project rebates, because about $1.8 million has already been obligated to particular projects (id. at 6, 13-14).[12]

B. Standard of Review

Pursuant to G.L. c. 164, § 17A, a gas or electric company must obtain written Department approval in order to "loan its funds to, guarantee or endorse the indebtedness of, or invest its funds in the stock, bonds, certificates of participation or other securities of, any corporation, association or trust . . . ." The Department has indicated that such proposals must be "consistent with the public interest," that is, a Section 17A proposal will be approved if the public interest is at least as well served by approval of the proposal as by its denial. Bay State Gas Company, D.P.U. 91-165, at 7 (1992); see Boston Edison Company, D.P.U. 850 (1983).

The Department has stated that it will interpret the facts of each Section 17A case on its own merits to make a determination that the proposal is consistent with the public interest. D.P.U. 91-165, at 7. The Department will base its determination on the totality of what can be achieved rather than a determination of any single gain that could be derived from the

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11 The systems benefit charge is a mandatory (fixed) charge per kilowatt-hour ("KWH") to Distribution Company customers to fund energy efficiency activities, including, but not limited to, demand-side management activities. G.L. c. 25, § 19. The systems benefit charge for the calendar years 2002 through 2007 is 2.5 mills ($0.0025) per KWH. Id. All electric Distribution Company energy efficiency programs are funded solely from the systems benefit charge. Id.

12 According to MECo, if interest charges were to be applied to municipal projects, about $9,200 would accrue to the Company's energy efficiency fund over a 24-month repayment period (RR-DTE-2).

proposed transactions. Id.; see D.P.U. 850, at 7. The Department also found that the consistency standard best accommodates the Department's interest in protecting the utility's ratepayers from the adverse effects of unwarranted Section 17A transactions and a utility's interest in having flexibility in a changing marketplace to meet long term objectives of its ratepayers and shareholders. D.P.U. 91-165, at 7; Boston Edison Company, D.P.U. 97-17, at 6 (1997).

Thus, the Department's analysis must consider the overall anticipated effect on ratepayers of the potential harms and benefits of the proposal. D.P.U. 91-165, at 8. The effect on ratepayers may include consideration of a number of factors, including, but not limited to: the nature and complexity of the proposal; the relationship of the parties involved in the underlying transaction; the use of funds associated with the proposal; the risks and uncertainties associated with the proposal; the extent of regulatory oversight on the parties involved in the underlying transaction; and the existence of safeguards to ensure the financial stability of the utility. Id.

C. Comments

DOER asserts that municipal customers are faced with a unique set of financial circumstances (DOER Comments at 1-2). DOER argues that enhanced rebates, on-bill financing, and cost-free technical assistance will therefore induce participation that would otherwise not occur (id. at 1-2). MCAN reiterates the arguments made by DOER and asserts that MECo's proposal will provide an increment of financial relief to local governments through lower electric bills (MCAN at 1).

D. Analysis and Findings

MECo requests approval of a financing arrangement that would facilitate participation of municipal customers in energy efficiency projects through enhanced rebates and on-bill financing of energy efficiency measures. We agree with DOER and MCAN's comments that increased municipal participation in energy efficiency programs might capture savings opportunities that would otherwise be foregone, and provide local benefits in the form of lower electricity bills. Further, the record indicates that the Design 2000plus and Energy Initiative programs estimate B/C ratios of 2.30 and 2.04 respectively (see Table 1 attached to this Order). As such, the likelihood of cost-effective expenditures for these programs is high. Ratepayers would not be harmed by these programs because the funds that would be spent for this proposal come solely from the systems benefit charge that can only be expended on cost-effective energy efficiency activities. G.L. c. 25, § 19. Accordingly, the Department finds that the Company's financing proposal is consistent with the public interest, and thereby approves the proposal.

V. 2003 SHAREHOLDER INCENTIVE PROPOSAL

A. Company Proposal

1. Incentive and Performance Levels

MECo proposes an alternative to the method set forth in DTE Guideline § 5.00 for calculating the after-tax shareholder incentives that may result from the implementation of Energy Efficiency Programs (Exh. MEC-3, at 88-90; Exh. MEC-2, Amended App. D, Table 1). MECo stated that AIM, the Energy Consortium, LEAN, and the Northeast Energy Efficiency Council support this proposal (Exh. MEC-3, at 88-90; MECo Letter to the

Department (January 13, 2003)).[13] In sum, MECo proposes: (1) to fix the after-tax shareholder incentive at five percent, and (2) adjust the upper and lower levels of performance from which the Company can obtain an incentive (together, "Proposed Incentive Method") (Exh. MEC-3, at 88-90).

With regard to MECo's proposal to fix the after-tax shareholder incentive at five percent, DTE Guideline § 5.3 provides that the shareholder incentive be calculated as the product of: (1) the average yield of three-month United States Treasury Bills ("T-Bill rate"); and (2) the total program implementation costs as included in a distribution company's energy efficiency plan. For its 2003 Plan, MECo proposes to use a fixed rate of five percent instead of the T-Bill rate in this calculation (Exh. MEC-3, at 88-90, App. D). MECo stated that this modification is necessary because the "very low" prevailing T-Bill rate "may not provide an appropriate incentive" (id., at 88). The Company provided evidence that T-Bill rates for the years 2000-2002 were 6.00 percent, 3.51 percent, and 1.63 percent, respectively (Exh. DTE-1-8).

With respect to MECo's proposal to adjust the upper and lower levels of performance from which MECo can obtain an incentive, pursuant to DTE Guideline § 5.00, a distribution company may earn a shareholder incentive if its energy efficiency program is found to have operated within a threshold and exemplary performance levels of 75 percent to 125 percent of

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13 The Department notes that all electric distribution companies have submitted similar proposals for an alternative to the DTE Guidelines for their 2003 energy efficiency plans.

design level respectively, as measured during the post-implementation phase.[14] In other words, a distribution company that does not achieve at least 75 percent of its design performance level would receive no shareholder incentive, while a distribution company whose performance level exceeded the 75 percent threshold would receive a shareholder incentive that would vary based on its actual performance level, up to 125 percent of the design performance level. D.T.E. 98-100, at 18. In its 2003 Plan, MECo proposes to establish a threshold performance level of 70 percent and exemplary performance level of 110 percent of design level (Exh. MEC-3, at 88).

MECo applied the Proposed Incentive Mechanism to its 1998-2001 energy efficiency plans, noting that it would have earned shareholder incentives ranging from $2.053 million to $3.24 million under this method (Exh. DTE-1-8). Using the Proposed Incentive Method in terms of its 2003 Plan, MECo projects that it would earn a shareholder incentive of about $2.5 million (Exh. MEC-3, at 90).

2. Determinants of Shareholder Incentives

For its 2003 Plan, MECo proposes to have three determinants of its shareholder incentive, a savings determinant, a value determinant, and a performance metric determinant (Exh. MEC-3, at 88-90, App. D). MECo stated that the savings determinant is driven by the ability of its energy efficiency programs to deliver capacity savings, energy savings, and non-electric benefits (id. at 89). The Company stated that consistent with its bandwidth proposal, at least 70 percent of the respective design level energy, capacity, and non-electric benefits

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[14] MECo stated that the design level consists of achieving 100 percent of the goal set forth in its 2003 Plan (Exh. MEC-3, at 88).

must be achieved before a shareholder incentive may be earned under this determinant (id., App. D, Table 2).

MECo stated that its value determinant is driven by the ability of its energy efficiency programs to produce net benefits (id. at 88). That is, the value determinant rewards the Company for lowering the costs and/or increasing the benefits of its energy efficiency programs (id. at 89). MECo stated that its programs must produce at least 70 percent of the design level net benefits before an incentive may be earned under this determinant (id., Amended App. D, Table 3). MECo stated that its savings, value, and performance metric determinants account for 47, 19, and 34 percent, respectively, of its 2003 shareholder incentive (id.).

B. DOER Report

DOER recommends approval of MECo's Proposed Incentive Method (DOER Report at 4). DOER stated that the Proposed Incentive Method is the product of extensive discussions with distribution companies, stakeholders, and DOER (id.). DOER noted that the Proposed Incentive Method has been developed for use by all Massachusetts distribution companies, and that, if adopted on that basis, it will provide uniformity in terms of the shareholder incentive method (id. at 3-4). DOER asserted that the Proposed Incentive Method is designed to more directly align the energy efficiency goals of distribution companies with energy efficiency goals of ratepayers (id. at 4).

With regard to the proposed five percent element in the calculation of its after-tax shareholder incentive, DOER contends that recent T-Bill rates have been much too low to adequately motivate distribution companies to provide high quality energy efficiency programs (id. at 3). DOER stated that, for example, from April to December of 2001, the T-Bill rate fell from 3.97 percent to 1.72 percent (id.). By December 2002, the T-Bill rate had fallen to 1.21 percent (id.). DOER concludes that the downward trajectory and variability of the recent T-Bill rates have been detrimental to distribution company efforts to design and deliver energy efficiency programs (id. at 5).

With regard to MECo's proposal to adjust the upper and lower levels of performance from which the Company can obtain an incentive, DOER argues that the "wide" 75 to 125 percent bandwidth in the DTE Guidelines is no longer appropriate because, with experience gained over recent years, energy efficiency program performance can now be more accurately predicted (id.). DOER contends that 70 percent is appropriate as a bandwidth minimum because this level will allow MECo to better absorb the risks associated with this Proposed Incentive Method (id. at 6). DOER asserted that capping the upper bound at 110 percent instead of 125 percent is appropriate because the lower cap will conserve energy efficiency funds without impairment to distribution company motivation because the new cap is part of a larger arrangement that includes the 5 percent rate (id.). DOER estimated that the 110 percent cap could reduce exposure to ratepayers for after-tax incentive payments to distribution companies by nearly 1.25 percent, and this savings could instead be spent on energy efficiency activities (id.).

DOER did not comment on MECo's proposal to include savings and value determinants when calculating shareholder incentives.

C. Analysis and Findings

1. Incentive and Performance Levels

When an entity seeking Department approval of its Plan requests a different method from that specified in the Guidelines, the burden falls on that entity to demonstrate the compelling nature of such a request. DTE Guidelines at § 1(2). In this proceeding, MECo has proposed (1) a fixed shareholder incentive rate of 5.00 percent, instead of the T-Bill rate, in calculating its shareholder incentive and (2) a threshold performance level of 70 percent, and exemplary performance level of 110 percent of design level for use in its calculation of shareholder incentives.

The Department previously granted an exception to the DTE Guidelines that allowed distribution companies to use a fixed rate of 4.25 percent instead of the 2002 T-Bill as an element in calculating their shareholder incentives. NStar Electric Company, D.T.E. 00-63-A at 8 (2003); Western Massachusetts Electric Company, D.T.E. 00-79-A at 7 (2003); Massachusetts Electric Company and Nantucket Electric Company, D.T.E. 00-65-A at 7 (2002). The Department has recognized that the size of an incentive must balance promoting good program management with benefitting ratepayers by directing most of the budget to program implementation. Order Promulgating Proposed Guidelines to Evaluate and Approve Energy Efficiency Programs, D.T.E. 98-100, at 37 (1999). DOER, the agency charged by the Legislature with much of the oversight of energy efficiency programs, has agreed that offering an incentive is needed to motivate companies to manage their energy efficiency programs well. Id. at 35. DOER maintained that an incentive of four to six percent, equal to a three to four percent riskless real rate of return plus an inflation rate of one to two percent, would be sufficient to motivate electric companies to manage energy efficiency programs well. Id. at 36. DOER stated that the then-recent T-Bill rate fell in the required four to six percent range. Id.

The Company has provided evidence that the T-Bill rate is now lower than the rate recommended by DOER in D.T.E. 98-100. While MECo's proposed five percent after-tax rate exceeds the rate now provided for in the DTE Guidelines, and the method approved in D.T.E. 00-65-A, it is near the middle of the range that DOER proposed in D.T.E. 98-100. The Department reaffirms that an incentive must be large enough to promote good program management, but small enough to leave almost all of the money to directly serve customers. The Company's proposal balances these two objectives, and is consistent with DOER information that the Department used in formulating the DTE Guidelines. The Department finds that the Company has met its burden to demonstrate the need for its request for an alternate method to calculate shareholder incentives in 2003. DTE Guidelines at § 1(2). Accordingly, the Department grants the Company's request for an exception to the DTE Guidelines, and grants MECo's request to use five percent instead of the T-Bill rate in calculating after-tax shareholder incentives for the 2003 Plan for calendar year 2003.

The record indicates that MECo's proposal to establish a threshold performance level of 70 percent and exemplary performance level of 110 percent of design level is the product of extensive discussions between distribution companies, stakeholders, and DOER. DOER has concluded that implementation of this tighter bandwidth is justified because, with experience gained in recent years, the performance of energy efficiency programs can now be charted more accurately. DOER also estimated that lowering the threshold level might result in more funds to be spent on energy efficiency activities, instead of on after-tax shareholder incentives. The Department agrees with DOER's conclusions. See DTE Guidelines at § 6.2(5). In light of DOER's conclusions, and the collaborative nature of the proposal, the Department finds that the Company has demonstrated the reasonableness of its proposal. Accordingly, the Department accepts the Company's proposal to establish a threshold performance level of 70 percent and exemplary performance level of 110 percent of design level.

2. Determinants of Shareholder Incentives

The Department notes that the savings and value determinants proposed by MECo represent a shift in scope and emphasis when compared to the existing shareholder incentive arrangement. Distribution companies may express the level of performance they expect to achieve in implementation of their energy efficiency programs in levels of savings, in energy commodity and capacity, and in other measures of performance as appropriate.
DTE Guidelines at § 5.2. Here, the Company has established "other measures of performance."

Under the Company's proposed method, the savings and value determinants will account for 66 percent of shareholder incentive monies while performance metrics will account for the remaining 34 percent. The Department notes that the savings and value determinants promise to reward energy efficiency accomplishments and cost reduction, and recognizes the importance of a mechanism that makes this relationship visible. In addition, the Department notes the importance of cost reduction as a means of rewarding superior management and promoting effective use of energy efficiency funds. Accordingly, the Department finds that the Company's savings and value determinants are appropriate.

VI. ORDER

Accordingly, after due notice, hearing, and consideration, it is hereby

ORDERED: That the Petition of Massachusetts Electric Company and Nantucket Electric Company for approval of its energy efficiency program for 2003 be and is hereby APPROVED; and it is

FURTHER ORDERED: That the petition of Massachusetts Electric Company and Nantucket Electric Company, pursuant to G.L. c. 164, 17A, for approval of a financing arrangement with municipal customers be and is hereby APPROVED; and it is

FURTHER ORDERED: That Massachusetts Electric Company and Nantucket Electric Company follow all other directives contained in this Order.

By Order of the Department,

____________/s/________________
Paul G. Afonso, Chairman

____________/s/________________
James Connelly, Commissioner

____________/s/________________
W. Robert Keating, Commissioner

____________/s/________________
Eugene J. Sullivan, Jr., Commissioner

____________/s/________________
Deirdre K. Manning, Commissioner

TABLE 1. MECo Energy Efficiency Budget ($000) and Planned Benefit/Cost Ratios

	2003	
	Budget	**B/C Ratio**
Residential, Ordinary		
New Construction (includes Low-Income New Homes)	**2,529**	**1.59**
In-Home Services		
Energy Wise	**5,155**	**1.02**
RCS	**3,678**	**1.02**
Products and Services		
Lighting	**2,902**	**2.05**
Energy Star Appliances	**2,545**	**1.16**
Home Energy Management (Water Heater Control)	**556**	**1.77**
Other Load Response	**275**	**NA**
Misc. Evaluation	**207**	**NA**
Subtotal Residential, Ordinary	**17,847**	**1.25**
Low-Income		
In-Home Services	**6,439**	**2.56**
Total Residential	**24,286**	**1.50**
Commercial / Industrial		
Design 2000+	**13,514**	**2.30**
Energy Initiative	**10,626**	**2.04**
Small Business	**4,284**	**2.07**
Load Response	**257**	**NA**
Misc. Evaluation	**311**	**NA**
Total Commercial/Industrial	**28,992**	**2.13**
Tax on Shareholder Incentive	**1,613**	**NA**
TOTAL BUDGET	**54,891**	**1.83**

Sources: Exh. DTE-1-9 (Rev.), Amended App. A-v2; Exh. MEC-3 at Table 2.
Notes: B/C ratios include participant costs, not shown in the budget amount.
Shareholder performance incentives are allocated across programs within the residential or C/I sector, according to the benefits created by each program.
Miscellaneous planning and evaluation expenses are allocated across programs.